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TAGS: [ECON](#) [EFIN](#) [PO](#)  
SUBJECT: PORTUGAL FINANCIERS FORESEE LEAN TIMES AHEAD

Classified By: AMBASSADOR THOMAS STEPHENSON FOR REASONS 1.4 (B,D)

#### SUMMARY

1. Six leading Portuguese financiers told the Ambassador the Portuguese financial market is "getting by" with decreasing profits during the current "deleveraging" period. Although there is some concern about bank liquidity, the GOP is expected to announce a bank recapitalization program next week and the group views the home mortgage market as reasonably sound. The executives generally support recent U.S. and European market interventions, and the financial industry in Portugal is taking a more conservative stance and refocusing on its core businesses. The meeting's strongest points regarded the need for the U.S. to undertake "significant homework" to repair its tarnished reputation as the leader in global finance, as China and other countries with higher liquidity gain prominence. End summary.

#### PORTUGUESE MARKETS ARE BASICALLY SOUND

2. In an October 23 breakfast meeting at the Ambassador's residence, executives from six leading financial institutions in Portugal shared their views on the current global financial crisis, its effect on their operations, and the outlook for Portugal going forward. Attending the meeting were Fernando Ulrich of Banco BPI, Pedro Penalva of AIG Europe, Paulo Gray Pereira of Citibank International, Nuno Amado of Santander Totta, Miguel Melo Azevedo of Merrill Lynch, and Joao Oliveira-Rendeiro of Banco Privado Portugues (BPP). The group consensus was captured by Fernando Ulrich, CEO of Banco BPI, who described Portuguese financial markets as fundamentally sound and "getting by", but with lower profits due to increasing costs of capital. Amado described this period as a "deleveraging cycle" which will be painful to go through but less so in Portugal than elsewhere. All agreed with the Ambassador who surmised that Portugal's conservative policies, which in the past have resulted in slower overall economic growth, were now paying dividends due to limited exposure in devalued investments.

3. In a minority view, Oliveira-Rendeiro of BPP expressed concern over the solvency of Portuguese institutions because "savings in Portugal are not high enough" in this "leveraged economy" and worried that the 20 billion euro credit line available to ailing institutions announced by the GOP on October 19 might not be enough. (Note: this credit line is available to banks on a voluntary basis and is essentially a guarantee on senior, higher-priority debt. End note.) Oliveira-Rendeiro also suggested the minimum Tier 1 capital ratio (the ratio of institution equity to risk-adjusted assets) could be increased to 9 percent, but Paulo Gray Pereira of Citibank disagreed, saying the required level of capital must be "...in accord with the state of the economy", and it would be impossible for banking in Portugal to be profitable with such a high equity requirement. However,

Gray claimed the GOP is working on a bank recapitalization program in which the GOP would buy preferred shares of Portuguese banks, which he expects will be announced sometime next week.

14. The group also generally agreed that the home mortgage market in Portugal is sound, although Ulrich claimed state-run Caixa Geral de Depositos had issued "lots of sub-prime mortgages." Portuguese borrowers also risk increasing mortgage payments due to the credit crunch, because mortgages here typically have variable interest rates. However, Gray downplayed the risk for mass defaults in the Portuguese mortgage markets because borrowers here do not have the ability to "walk away" from their mortgages as borrowers can in the U.S. and elsewhere.

#### MARKET INTERVENTIONS WELCOMED, AND GETTING BACK TO BASICS

15. The group supported recent market interventions by the U.S. and European countries, but some questioned the U.S. decision to allow Lehman Brothers to fail. Nuno Amado, Chairman of the Board of Santander Totta, opined that costs of shoring up the financial markets might have been less had the U.S. intervened to support Lehman. While there was some head nodding to this point, all agreed when the Ambassador replied there will undoubtedly be future post mortems of the actions taken to deal with the crisis, but at the time it was deemed important for the financial markets to understand that the U.S. government was not a backstop for poor corporate decision-making.

16. Due to leaner profits, the industry is refocusing on

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business basics. Citibank's Gray said Citi's consumer business has traditionally focused on pushing credit cards, accepting a default rate of 2-3 percent of outstanding credit. However, since May-June of this year, default rates have increased significantly, and Gray said the latest projections estimate default rates for 2008 and 2009 at a multiple of previous levels. Gray commented that credit card defaults are an early indicator of worsening trends because they are the last bills those in financial trouble will pay. In response to this trend, Citi has shifted focus toward management and retention of existing accounts and instituted a monthly cap on opening new accounts. Gray said while Citi seeks to minimize defaults by establishing payment plans with delinquent borrowers, the company has increased staffing in its collections operation from 50 to 120 in just a few months. Citi's corporate banking operations are also increasingly conservative, and are no longer generally encouraging borrowers to draw upon available credit. Likewise, Pedro Penalva of AIG Europe said AIG is refocusing on insurance operations and divesting itself of financial ventures that he claimed were the primary cause of AIG's recent difficulties.

#### U.S. NEEDS TO REPAIR CREDIBILITY

17. Ulrich of Banco BPI sounded the most critical note of the meeting, saying the U.S. "needs to do a lot of homework" to repair its credibility due to the crisis. Ulrich's ire was particularly targeted at U.S. rating agencies, saying it was "fraudulent" for raters to give the same (equally high) ratings to Lehman Brothers and AIG immediately before their respective crises as they gave to Banco BPI. Ulrich decried the lack of regulation for credit default swaps and other complex investment instruments as "scandalous" and described some U.S. accounting rules as "rubbish," insisting he would not do as much business in the future with U.S. institutions as he had in the past.

18. His frustrations vented, Ulrich concluded with a request for increased public relations from the Embassy to counter animosity toward the U.S. as the instigator of the crisis. "Please do the homework, because the world needs it", Ulrich

concluded. Oliveira-Rendeiro of BPP ended the meeting on a provocative note, saying the crisis marked a change in "the balance of power" in world finance, with China and emerging nations which retain liquidity coming to the fore, "and maybe that is good".

COMMENT - "GUARDED OPTIMISM"

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19. Although we anticipated some reluctance to discuss the ongoing crisis candidly, our guests were relatively open regarding impacts on their businesses and future prospects in Portugal. In contrast to more gloomy prospects foreseen by larger European countries more highly leveraged in devalued assets, Portuguese financiers are guardedly optimistic about the Portuguese economy and judge U.S. and European actions as probably sufficient to put financial markets on the road to recovery. However, all of our guests tempered their optimism, saying "in two or three months things could look different". Post plans on scheduling similar events with other Portuguese finance executives in the near future as the global crisis unfolds. End comment.  
STEPHENSON